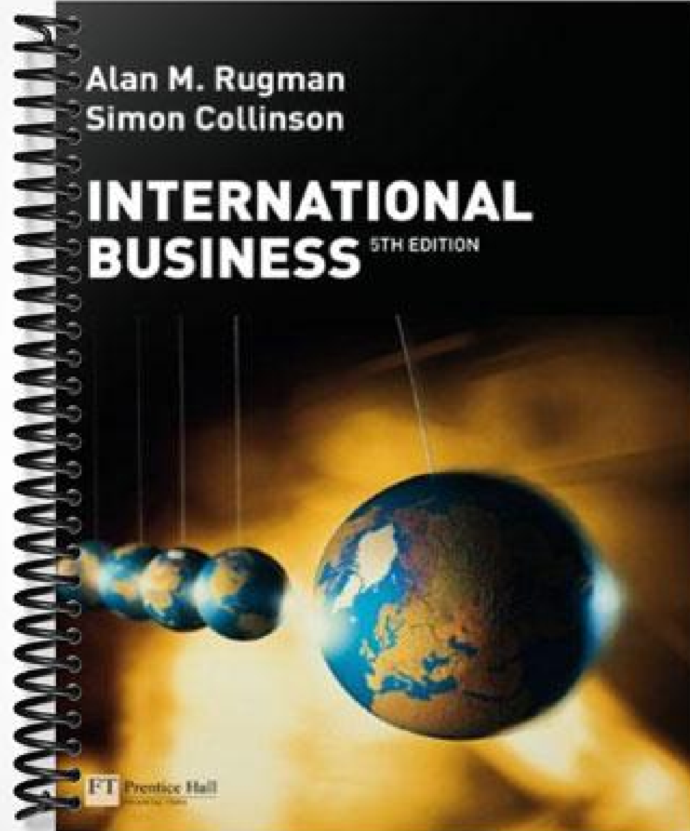
SOLUTIONS MANUAL



CHAPTER 2

The multinational enterprise

Chapter objectives

1. Describe the characteristics of multinational enterprises.
2. Explain the internationalization process.
3. Explain why firms become multinational enterprises.
4. Discuss the strategic philosophy of these firms.
5. Introduce a country/firm framework for examining a firm's competitiveness.
6. Study some of the ways in which these firms use strategic management.

Chapter summary

1. A multinational enterprise is a company that is headquartered in one country but has operations in two or more countries. There are a series of characteristics that are common to multinational enterprises. These include: (a) affiliated firms that are linked by ties of common ownership; (b) a common pool of resources; and (c) a strategic vision that guides all the affiliates.

2. Multinationals, especially large industrial enterprises, account for a large percentage of world sales and employment. Multinational enterprises (MNEs), large or small, also engage in a wide variety of business activities, ranging from manufacturing to retailing to consulting services.

3. The internationalization process is one of going abroad at incremental stages, on the premise that foreign markets are risky. Thus, a typical process is: license, export, sales office and finally foreign direct investment (FDI).

4. Companies become MNEs for a number of reasons: (a) a desire to protect themselves from the risks and uncertainties of the domestic business cycle; (b) a growing world market for their goods or services; (c) a response to increased foreign competition; (d) a desire to internalize in order to reduce costs; (e) a desire to overcome tariff barriers; and (f) a desire to take advantage of technological expertise by manufacturing goods directly rather than allowing others to do it under a license agreement.

5. Multinational enterprises have a strategic philosophy that is different from that of home country businesses. In particular, MNEs do not see their company as an extension of its domestic roots. They hire the personnel, fire and transfer them to meet global needs, even if this means laying off home country employees. They also combine their talents with those of other MNEs in creating, financing and managing joint ventures.

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6. Successful MNEs rely on the strategic management process, which has five major phases: (a) identification of the firm's basic mission; (b) external and internal environmental analysis; (c) formulation of objectives and overall plans; (d) implementation of these plans; and (e) evaluation and control of operations.

7. Managers of most MNEs use strategies that build upon Firm-Specific Advantages (FSAs) and Country-Specific Advantages (CSAs). The FSAs are strengths or benefits specific to a firm and a result of contributions that can be made by its personnel, technology and/or equipment. The CSAs are strengths or benefits specific to a country that result from its competitive environment, labor force, geographic location, government policies, industrial clusters, etc.

8. The key concepts in this book can be brought together in the framework of the FSA – CSA matrix. The multinational enterprises have FSAs that can be related to home and host CSAs.

9. Thomas Friedman, a *New York Times* journalist, makes one point in his book *The World is Flat* that today a large proportion of international business takes place through offshoring leading to globalization. The FSA – CSA analysis counters this simplistic notion. The world is not flat, because there remain strong barriers as a business attempts to cross the boundaries of triad regions. It is necessary to investigate the manner in which a firm's business model may need to be adapted such that its FSAs can overcome the liability of inter-regional foreignness.

Chapter outline

Introduction

The nature of multinational enterprises
- Characteristics of multinational enterprises
- The internationalization process
- Why firms become multinational enterprises
- The strategic philosophy of multinational enterprises

Strategic management and multinational enterprises
- Strategic management of MNEs: an introduction
  - Steps in the strategic management process

A framework for global strategies: the FSA/CSA matrix
- The FSA-CAS matrix

It's regional, not flat

Multinationals in action
- Solectron
- BMW
- Levi Strauss
- Canon
- Zara

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Lecture outline

A. Introduction

1. A (MNE) is a firm headquartered in one country with operations in other countries. Sometimes it is difficult to know if a firm is an MNE, because multinationals often downplay the fact that they are foreign-held.

B. The nature of multinational enterprises

1. Multinational enterprises (MNEs) have a number of characteristics including the following: (a) responsiveness to environmental forces such as competitors, customers, suppliers, financial institutions and government; (b) drawing on a common pool of resources, including assets, patents, trademarks, information and human resources; and (c) affiliates that are linked by a common strategic vision.
2. Under the premise that foreign markets are risky, companies expand their operations abroad incrementally and cautiously. Setting up a wholly owned subsidiary is usually the last stage of doing business abroad. A typical internationalization process for a firm producing a standardized product might begin with a licensing agreement: a contractual arrangement in which one firm provides access to some of its patents, trademarks, or technology to another firm in exchange for a fee or royalty. Apart from a licensing agreement, a firm might export via an agent or distributor. This might be followed by the direct hiring of a domestic representative or the establishment of a foreign sales subsidiary. The next step might be the establishment of local packaging and/or assembly operations. This is typically followed by FDI.
3. Firms become multinationals for a number of reasons. Some of these include the following: (a) a desire to protect themselves from the risks and uncertainties of the domestic business cycle; (b) a growing world market for their goods or services; (c) a response to increased foreign competition; (d) a desire to reduce costs; (e) a desire to overcome tariff barriers; and (f) a desire to take advantage of technological expertise by manufacturing goods directly rather than allowing others to do it under a license agreement.
4. Multinational enterprises are different from companies that confine their activities to the domestic market. MNEs make decisions based primarily on what is best for the company, even if this means transferring funds or jobs to other countries.

C. Strategic management of multinational enterprises

1. The strategic management process involves four major functions: strategy formulation, strategy implementation, evaluation and the control of operations.
2. Strategic planning typically begins with a review of the company's basic mission. This is determined by answering the questions: What is the firm's business? What is its reason for existence? By answering these questions, the company reaffirms the direction in which it wants to go. In recent years, many MNEs have revised their strategic plan because they realized that they had drifted too far away from their basic mission.
3. After determining its mission, the MNE will evaluate the external and internal environments. The goal of external environmental analysis is to identify opportunities and threats that will need to be addressed. The purpose of internal environmental analysis is to evaluate the company's financial and personnel strengths and weaknesses.

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4. Internal and external analysis helps the MNE identify both long-range goals (typically two to five years) and short-range goals (less than two years). The plan is then broken down into major parts, and each affiliate and department will be assigned goals and responsibilities. This begins the implementation process. Progress is then periodically evaluated and changes are made in the plan.

D. A framework for global strategies: the FSA – CSA matrix

1. Much of the material in this book can be synthesized within a single analytical framework. There are two basic building blocks that determine the competitive advantage of an organization: FSAs and CSAs. The FSAs are defined as unique capabilities proprietary to the organization. These may be built upon product or process technology, marketing or distributional skills. The CSAs are country factors that may be based on natural resource endowments (minerals, energy, forests) or on the labor force, and associated cultural factors. Managers of most MNEs use strategies that build upon the interactions of CSAs and FSAs.
2. Figure 2.5, the competitive advantage matrix, provides a useful framework for the discussion of the relative strengths and weaknesses of the CSAs and FSAs that the MNEs possess. A strong FSA implies that, under identical CSAs, a firm has a potential competitive advantage over its rivals.
3. Quadrants 1, 2 and 3 correspond broadly to the three generic strategies suggested by Porter (1980): cost leadership, differentiation and focus. Quadrant 3 firms generally can follow any of the strategies. Firms in quadrant 4 are generally differentiated firms with strong FSAs in marketing and customization. Basically, these firms follow a differentiation strategy. In quadrant 4 the FSAs dominate, so in world markets the home country CSAs are not essential in the long run. Quadrant 1 firms are generally resource-based and/or mature, globally oriented firms producing a commodity-type product. Given their late stage in the product life cycle, production FSAs flowing from the possession of intangible skills are less important than the CSAs of location and energy costs, which are the main sources of the firm's competitive advantage. Thus, these firms are following low cost and price competition strategies. Quadrant 2 firms represent inefficient, floundering firms with no consistent strategy, nor any intrinsic CSAs or FSAs. These firms are preparing to exit or to restructure. Quadrant 2 can also represent domestically based small and medium-sized firms with little global exposure.
4. In terms of business strategy, quadrants 3 and 2 are unambiguous in their implications. A quadrant 3 firm can benefit from the strategies of both low cost and differentiation. Such a firm is constantly evaluating its production mix. As a product line matures and then declines it eventually graduates to quadrant 2. However, by adopting new product lines, developing dynamic organizational capabilities and maintaining an effective strategy, the firm can maintain its overall position in quadrant 3. In quadrant 2, there is no alternative but to restructure, or, to eventually leave the market.
5. Quadrants 4 and 1 are credible positions for different types of firms. For instance, a quadrant 4 firm that has strong FSAs in marketing (customization) can operate globally without relying on its home-market CSA, or the CSAs of the host nation. For such a firm, quadrant 4 does not signal a CSA weakness; the CSA is not relevant. In contrast, quadrant 1 has mature multinationals or product lines determined more by CSAs than by FSAs. By improving potential FSAs in marketing or product innovation and increasing value added through vertical integration, the quadrant 1 firm can move to quadrant 3, where its profitability should be enhanced.

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6. The FSA-CSA framework in Figure 2.5 can be reconciled with the OLI framework of Dunning (1981). In this eclectic paradigm, Dunning has location factors (L), internalization factors (I) and ownership factors (O). The location variable (L) is entirely consistent with the vertical axis of Figure 2.5. The horizontal axis shows the unique capabilities of the firm called FSAs. There is little value in distinguishing between the O and I aspects of FSAs. O and I, in practice, are integrated features of FSA management within the MNE that cannot be decoupled in strategic decision making.

E. It's regional, not flat

1. Thomas Friedman, the New York Times journalist, has sold over 3 million copies of his *The World is Flat*. He makes one point in his book, namely that today a large proportion of international business takes place through offshoring leading to globalization.
2. Indeed, much manufacturing and cost innovation takes place in China with service sector activities, especially in information technology sectors, taking place in India. While both types of offshoring certainly exist (and are explained by factor cost arbitrage), it is apparent that Friedman vastly exaggerates the importance of offshoring in the information technology related area.
3. The FSA – CSA analysis counters Friedman's simplistic notion. It can be seen that Friedman's book is mainly about cell 1, and that he presents no evidence of the way FSAs can be developed such that CSAs in China and India are transformed into cell 3 firm-specific attributes. The world is not flat, because there remain strong barriers as a business attempts to cross the boundaries of triad regions. It is necessary to investigate the manner in which a firm's business model may need to be adapted such that its FSAs can overcome the liability of inter-regional foreignness.

F. Multinationals in action

1. Most MNEs are not giant corporations, but the giants are almost all MNEs. Some of the exceptions are major utilities, banks and retailers that restrict their operations to the home country.
2. Multinational enterprises (MNEs) range from extremely large to fairly small in terms of both sales, employment and they can also be found in a variety of different industries.

Answers to review and discussion questions

1. What is a multinational enterprise? Is it likely that the number of MNEs will increase during the next decade? Why?

A MNE is a company that is headquartered in one country but has operations in two or more countries. It is likely that the number of MNEs will increase during the new millennium because of the lowering of trade tariffs and quotas and the fact that more and more firms are finding that in order to increase their sales and profit, they need to go international.

2. What are the three common characteristics of an MNE? Identify and briefly describe each.

The three common characteristics of an MNE are the following: (a) responsiveness to environmental forces such as competitors, customers, suppliers, financial institutions and government; (b) drawing on a common pool of resources, including assets, patents, trademarks, information and human resources; and (c) affiliates linked by a common strategic vision that tie them together.

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3. Why do firms become multinational enterprises? Identify and discuss four reasons.

Firms become multinationals for a number of reasons. Some of these include: (a) a desire to protect themselves from the risks and uncertainties of the domestic business cycle; (b) a growing world market for their goods or services; (c) a response to increased foreign competition; (d) a desire to reduce costs; (e) a desire to overcome tariff barriers; and (f) a desire to take advantage of technological expertise by manufacturing goods directly rather than allowing others to do it under a license agreement.

4. How are CSAs different than FSAs?

Country-specific advantages (CSAs) are country factors that may be based on natural resource endowments (minerals, energy, forests) or on the labor force, and associated cultural factors. Firm-specific advantages (FSAs) are firm-specific and are defined as unique capabilities proprietary to the organization. These may be built upon product or process technology, marketing or distributional skills. While FSAs refer to the specific abilities of the firm, CSAs refer to the environment in which the firm operates.

5. How successful are the large industrial MNEs? What accounts for this?

Many large industrial MNEs have been particularly successful, though there have been some notable exceptions. Success is accounted for by the organization's ability to formulate its strategy carefully and to use its massive resources to develop and market goods and services. Failure is a result of inefficient use of resources, thus driving up costs and making the firm noncompetitive, as well as the offering of goods and services that are being provided more cheaply or effectively by the competition.

6. What are the five basic steps in the strategic management process? Identify and briefly describe each.

The five basic steps in the strategic management process are these: (a) identify the firm's basic mission: the reason that a firm is in existence; (b) analyze the external and internal environments: the goal of external environmental analysis is to identify opportunities and threats that will need to be addressed, while the purpose of an internal environmental analysis is to evaluate the company's financial and personnel strengths and weaknesses; (c) formulate objectives as well as the overall plan: identify long-term (two to five years) and short-term goals (less than two years) for the firm; (d) implement the plan: the plan is then broken into major parts and each affiliate and department is assigned goals and responsibilities; and (e) evaluate and control operations: the plan is periodically evaluated and changes are made to accommodate changing circumstances and new information.

7. How has Zara used the strategic management process to help it become a successful multinational?

Zara has identified its basic mission as being part of the fashion industry. It has analyzed the external and internal environments of the countries in which it chooses to do business. It has developed short-term and long-term objectives for its domestic and foreign operations. The company implemented its foreign expansion in multiple markets. Zara has implemented a continuous evaluation and control of operations systems in which changing customer tastes are immediately conveyed to the production system.

8. How has Levi Strauss used the strategic management process to help it improve its competitiveness?

Originally, Levi sought to offer durable, functional and guaranteed denim clothes for US workmen. Slowly, the firm identified new opportunities and expanded its product line and its

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market segment. Increased competition forced it to reevaluate its overall plans and to relocate manufacturing to foreign countries where labor is more abundant. Upon evaluation of its market situation, the firm decided to create a cheaper brand to cater to customers in discount stores.

Answers to real cases

Starbucks

1. ***Why does Starbuck rely on licenses for most of its international operations? Does the firm risk the dissipation of its managerial or technological advantages?***

   Local owners with local knowledge and a similar strategic vision to that of Starbucks can do better than US managers that do not understand the local market and business environment. This decreases the risk faced by Starbucks in international markets. Furthermore, Starbucks might not have enough US managers to fill international positions.

   Starbucks' managerial and technological advantages might be dissipated. However, the firm's competitive advantage derives primarily from its brand name and image-building capabilities. While local managers might learn how to market another brand, they would have to start from scratch to do so.

2. ***Can you argue that Starbucks is a global company regardless of the strong dominance of its home region in terms of sales and locations? Explain.***

   From the perspective of how much revenue and income the company generates in each region, Starbucks is not a global company, but a homeregion oriented company in North America. The same is true if we consider that over 70 percent of its stores are located in North America. Starbucks is not a global company but a North American one.

3. ***What accounts for the discrepancy between percentage of foreign locations and percentage of foreign revenues?***

   Most foreign stores are owned by foreign nationals. The revenues that Starbucks generates are from the sales of products and from fees collected from these stores. That is, they do not include the total revenues of the store.

4. ***What are some of the reasons why Starbucks chooses to retain operational control of its domestic operations?***

   The reasons that Starbucks chooses not to rely on licensing in its home region are as follows. One is that the organization does not have to share profits with licensees. However, this comes with the increased cost of controlling all the coffee houses. Perhaps the most important reason, therefore, is that Starbucks sells itself as "quality" coffee and markets itself to a select group of urban professionals. Control of operations is therefore paramount for the success of the firm. The company cannot risk having franchise owners jeopardize their image. The firm only licenses stores when it wants retail space where there is no option but to license.

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Sony

1. Is Sony a Multinational Enterprise?

Yes. It is headquartered in Japan but has manufacturing, Research and Development (R&D) and marketing facilities in other countries.

2. If the vast majority of Sony's consumer electronics business is based and developed in Japan and the vast majority of Sony's music and movie business is based in the United States, does Sony make decisions that are best for the entire company regardless of location?

In this case there is at least mention of an attempt to make a decision that is best for the entire company regardless of location. The company held out from developing an MP3 player in Japan that could compete with Apple's iPod because it perceived that such a product could be used to infringe on the intellectual property rights of its US music and movie business.

3. Why does Sony need to license its technology to competitors?

The electronics industry is constantly standardizing itself. By licensing new products that need to work with other products, the company can increase supply, reach more customers and ensure that other complementary manufactures will make products that are compatible with their product, ensuring long-term success. Furthermore, this strategy might prevent competitors from developing competing products that follow different specifications.

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